

STATE OF IOWA

**INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

JUNE 30, 2016

State of Iowa

Officials

Name

Title

Executive Branch

Honorable Terry E. Branstad

Governor

David Roederer

Director, Department of Management

Legislative Branch

Pam Jochum (through Jan 8, 2017)

President of the Senate

Jack Whitver (effective Jan 9, 2017)

President of the Senate

Kraig M. Paulsen (through Jan 10, 2016)

Speaker of the House of Representatives

Linda L. Upmeyer (effective Jan 11, 2016)

Speaker of the House of Representatives

Glen P. Dickinson

Director, Legislative Services Agency

Judicial Branch

Mark S. Cady

Chief Justice of the Supreme Court



**OFFICE OF AUDITOR OF STATE
STATE OF IOWA**

Mary Mosiman, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

**Independent Auditor's Report on Internal Control
over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance with
Government Auditing Standards**

To the Governor and Members of the General Assembly:

We have audited in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the State of Iowa as of and for the year ended June 30, 2016, and the related Notes to Financial Statements, which collectively comprise the State of Iowa's basic financial statements, and have issued our report thereon dated December 14, 2016. Our report includes a reference to other auditors who audited the financial statements of the Tobacco Settlement Authority, the Iowa Public Television Foundation, the Iowa Finance Authority, the University of Iowa Foundation and Affiliate, the Iowa State University Foundation, the University of Northern Iowa Foundation, the University of Iowa Research Foundation and the University of Iowa Health System, as described in our report on the State of Iowa's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the Iowa Public Television Foundation, the University of Iowa Foundation and Affiliate, the Iowa State University Foundation and the University of Northern Iowa Foundation were not audited in accordance with Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Iowa's internal control over financial reporting to determine the audit procedures appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Iowa's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Iowa's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified a deficiency in internal control we consider to be a material weakness and other deficiencies we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility a material misstatement of the State of Iowa's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings as item (A) to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control which is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings as items (B) and (C) to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Iowa's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under Government Auditing Standards.


We noted certain immaterial instances of non-compliance or other matters which will be reported to management in separate reports.

The State of Iowa's Responses to the Findings

The State of Iowa's responses to the findings identified in our audit are described in the accompanying Schedule of Findings. The State of Iowa's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing and not to provide an opinion on the effectiveness of the State of Iowa's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the State's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.


MARY MOSIMAN, CPA
Auditor of State

December 14, 2016

State of Iowa

Schedule of Findings

Year ended June 30, 2016

Findings Related to the Financial Statements:

INTERNAL CONTROL DEFICIENCIES:

(A) Unemployment Benefits Fund

Iowa Department of Workforce Development

Criteria – A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements of the financial statements on a timely basis. Properly designed policies and procedures and implementation of the policies and procedures are an integral part of ensuring the reliability and accuracy of the financial statements:

Condition – To comply with governmental accounting and financial reporting standards for the Unemployment Benefits Fund, the Iowa Department of Workforce Development (IWD) has developed the MYIOWAUI system to track employer unemployment insurance contributions based on quarterly employer payroll reports. The system generates information regarding the balance of employer contributions receivable and delinquent accounts, including penalty and interest calculations, for financial reporting purposes. This activity is reported to the Iowa Department of Administrative Services – State Accounting Enterprise (DAS-SAE) in a GAAP package. The following were noted for the year ended June 30, 2016:

- (1) IWD overstated accounts receivable by \$13,160,081 and overstated the allowance for doubtful accounts by \$6,682,298 on the GAAP package Unemployment Benefits Fund page. As a result, the net accounts receivable balance was overstated by \$6,477,783. This was properly adjusted for reporting purposes.
- (2) IWD overstated accounts payable by \$3,329,124 on the GAAP package Unemployment Benefits Fund page. This was properly adjusted for reporting purposes.
- (3) According to IWD, an account goes to non-collectible status when the most recent debt creation date on the account is older than 720 days and the last payment was not received within 90 days. These accounts should be written off for reporting purposes and not be included in the balance reported in the GAAP package. During testing, \$339,978 of \$34,013,607 of contributions, \$241,387 of \$14,078,783 of interest and \$67,170 of \$1,754,831 of penalties older than 720 days were included in the accounts receivable balance reported in the GAAP package.

Cause – Although policies and procedures have been established to require independent review of year-end cut-off transactions to ensure financial statements are accurate and reliable, the review did not identify material errors made in the GAAP package by the preparer.

Effect – IWD employees did not detect the errors in the normal course of performing their assigned functions. As a result, material adjustments to the financial statements were necessary.

State of Iowa

Schedule of Findings

Year ended June 30, 2016

Recommendation – IWD should ensure financial information generated for the GAAP package is properly reviewed for accuracy. IWD should continue to modify the MYIOWAUI system to ensure the data is accurate, timely and conforms to established policy.

Response – For numbers (1) and (2), IWD will review reconciling pages to ensure numbers are accurate on the Unemployment Benefits Fund page in the GAAP package. For number (3), the discrepancy is caused from the comparison of the Employer Accounts Receivable created from the MYIOWAUI system and the Non-Collection List. The problem lies where uncollected debt is never removed from the MYIOWAUI system so uncollected debt older than 720 days appears on this report, but is removed from the Non-Collection List. The reason the debt is not taken out of the MYIOWAUI system is because there are times we consider the debt uncollectible; however, we do receive payment on this at a later date. If there is no way to correct this in the system a comparison between the two reports will need to be done before the accountant completes this portion of the GAAP package and then back those accounts which appear older than 720 days out of the calculation.

Conclusion – Response accepted.

(B) Financial Reporting

Criteria – A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements of the financial statements on a timely basis. Properly designed policies and procedures and implementation of the policies and procedures are an integral part of ensuring the reliability and accuracy of the State's financial statements.

Departments record receipts and disbursements in the Integrated Information for Iowa (I/3) system throughout the year, including the accrual period. Activity not recorded in the I/3 system is reported to the Iowa Department of Administrative Services – State Accounting Enterprise (DAS–SAE) in a GAAP package. The GAAP package is to be submitted to DAS–SAE by the first week of September each year.

(1) Iowa Department of Commerce

Condition – The following findings were noted:

- (a) Prepaid expenses were understated by \$1,422,623. This was properly adjusted for reporting purposes.
- (b) Construction commitments and other contractual obligations were overstated by \$ \$1,310,873. This was properly adjusted for reporting purposes.

Cause – Policies have not been established and procedures have not been implemented to require an independent review of year-end cut-off transactions to ensure the State's financial statements are accurate and reliable.

Effect – Lack of policies and procedures resulted in Department employees not detecting the error in the normal course of performing their assigned functions.

State of Iowa

Schedule of Findings

Year ended June 30, 2016

Recommendation – The Department should establish procedures to ensure all prepaid expenses are identified and properly reported in the GAAP package.

Response – The Comptroller and Accountant II received advice from DAS-SAE regarding the appropriate way to account for obligated costs incurred by the Division for construction contracts and improvements within the FY2016 GAAP package. The GAAP package submitted by the Division was reviewed by DAS-SAE and was later reviewed by the Auditor's office. The Division was notified by the Auditor's office that revisions were to be made to the GAAP package. These revisions have been completed in accordance with the Auditor's findings. The Division will work with DAS-SAE and the Auditor's office on future GAAP reporting issues and questions to ensure accurate and complete data is submitted.

Conclusion – Response accepted.

(2) Iowa Communications Network

Condition – The Iowa Communications Network (ICN) did not disclose its lessor arrangements in the GAAP package. As a result, the footnote disclosure for lessor operating leases understated future rentals on operating leases by \$2,169,259.

Cause – Although policies and procedures have been established to require an independent review of the GAAP package, the review did not identify the GAAP package was not complete

Effect – Lack of detection of the GAAP package error by ICN's independent review procedures resulted in an incomplete footnote disclosure.

Recommendation – The ICN should ensure the GAAP package information is complete and accurate.

Response - The ICN will implement procedures to ensure the GAAP package is reviewed independently by qualified individuals before submission to the GAAP Team.

Conclusion – Response accepted.

(3) Iowa Economic Development Authority

Condition – The Authority overstated the amount of contractual commitments by \$867,625. This was properly adjusted for reporting purposes.

Cause – Although policies and procedures are in place to review GAAP package information, the review did not identify the overstatement of contractual commitments.

Effect – The amount reported as contractual commitments by the Department were overstated.

Recommendation – The Authority should develop and implement additional procedures to ensure the footnote information reported to DAS-SAE is accurate.

Response – The Authority will develop additional procedures to improve both the calculation and subsequent review of entity wide adjustments to ensure these items are correct for financial statement purposes.

Conclusion – Response accepted.

State of Iowa

Schedule of Findings

Year ended June 30, 2016

(4) Iowa Department of Education

Condition – Prepaid expenses were understated by \$795,500. This was properly adjusted for reporting purposes.

Cause – Policies have not been established and procedures have not been implemented to require an independent review of year-end cut-off transactions to ensure the State's financial statements are accurate and reliable.

Effect – Lack of policies and procedures resulted in Department employees not detecting the error in the normal course of performing their assigned functions.

Recommendation – The Department should establish procedures to ensure all prepaid expenses are identified and properly reported in the GAAP package.

Response – The Department acknowledges the Auditor's comments. Immediately upon discovery of this issue the Department carefully examined the situation and determined that prepaid expenses were understated on the GAAP package. The Department then performed an extensive review to determine whether or not other prepaid expenses existed. No other prepaid expenses were found. The Department has established a process to review transactions for prepaid expenses and report them properly on the GAAP package. Also, the Department is striving to eliminate prepaid expenses unless the prepaid expense creates a tangible benefit to the State.

Conclusion – Response accepted.

(C) Capital Assets

Iowa Department of Commerce

Criteria – A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements of the financial statements on a timely basis. Properly designed policies and procedures and implementation of the policies and procedures are an integral part of ensuring the reliability and accuracy of the State's financial statements.

Chapter 7A.30 of the Code of Iowa requires each department of the State to maintain a written, detailed and up-to-date inventory of property under its charge and control.

Condition – The following findings were noted:

- (a) The Department did not perform a timely reconciliation of capital asset additions to I/3 expenditures.
- (b) The beginning balances for governmental capital assets and the related accumulated depreciation did not agree to the prior year ending balances. This was properly adjusted for reporting purposes.

State of Iowa

Schedule of Findings

Year ended June 30, 2016

- (c) For the business type capital assets, construction in progress additions were understated by \$1,009,968, buildings and building improvement additions were overstated by \$481,444, accumulated depreciation additions for buildings and building improvements was overstated by \$481,444, machinery and equipment accumulated depreciation additions were incorrectly reported as deletions of \$104,460 and the beginning balance for machinery and equipment accumulated depreciation did not agree to the prior year ending balance. These were properly adjusted for reporting purposes.
- (d) Intangible asset additions were understated by \$98,117. This was properly adjusted for reporting purposes.

Cause – Policies have not been established and procedures have not been implemented to require a timely reconciliation of capital asset additions to I/3 expenditures and an independent review of capital asset additions to ensure they are properly capitalized.

Effect – Lack of policies and procedures resulted in Department employees not detecting the errors in the normal course of performing their assigned functions.

Recommendation – The Department should develop written procedures to ensure a detailed, up-to-date capital asset listing is maintained. Procedures should include, but not be limited to, ensuring all capital asset additions are reconciled to I/3 asset purchases. The reconciliation should also be reviewed by a person independent of the record keeping process. The independent reviewer should sign and date the reconciliation as evidence of review. In addition, the Department should ensure capital assets are capitalized in the correct amounts.

Response – The Division's current asset listing will be reviewed on a yearly basis by the Chief Operating Officer, Comptroller and the Accountant II. Should revisions need to be made to the asset listing, the Comptroller will review the asset listing at that time and make the necessary adjustments. The Division will also explore the application of the I/3 asset listing to the Division's operations. Should the I/3 asset listing module prove sufficient for the needs of the Division, the current asset listing will be migrated into the I/3 system. This will provide the Division with a consolidated listing, as well as the ability to reconcile all assets in the I/3 system.

Conclusion – Response accepted.

INSTANCES OF NON-COMPLIANCE:

No matters were noted.